

TO: Files

CC: The Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Les Girard, October 19, 2005

DATED: October 27, 2005

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On Wednesday, October 19, 2005, Michael Schachter and I, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Les Girard at the City Administration Building ("CAB"), 202 C Street in San Diego, in a conference room on the third floor. Mr. Girard was represented by counsel, Robert Friese, of Shartsis Friese LLP. Also present at the interview was Omid Yazdi of KPMG. Mr. Friese requested that the notes taken by the Audit Committee during the course of the interview be handwritten rather than typed, and the Audit Committee complied with his request. Mr. Friese also requested an opportunity for Mr. Girard to review the interview summary once it was completed, and Mr. Schachter explained that we could not comply with that request, in part, in order to preserve the work product nature of the memo.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Les Girard, and constitutes protected work product. It is not nor is it intended to be a transcript of the interview.

### *Warnings*

Mr. Schachter began the interview by informing Mr. Girard that Willkie Farr & Gallagher LLP is counsel to the Audit Committee for the City of San Diego (the "City"), and does not represent Mr. Girard or any employee of the City individually. He stated that the City of San Diego retained the Audit Committee to conduct an investigation, in part to give confidence to KPMG in the City's financial reporting. He said that the Audit Committee may write a report that may be used by KPMG and governmental agencies, and therefore Mr. Schachter emphasized the importance of Mr. Girard being accurate and truthful in his responses. Mr. Schachter also told Mr. Girard that the communication was not a privileged one, but that we did ask that he keep it confidential. Mr. Schachter informed Mr. Girard that the focus of the interview will be on issues pertaining to wastewater and the City's compliance with certain requirements regarding setting sewer user rates.

Before commencing the interview, in response to whether there were any questions, Mr. Friese offered by way of context that the Audit Committee had been formed indirectly as a result of the efforts of Mr. Friese and Mr. Girard. Mr. Friese had approached Turner, who in turn brought in Levitt and the rest of the Committee and counsel to it. Mr. Friese said he was mentioning that fact so that we understood that they were here to help. Mr. Girard cautioned that he learned a lot in 2003 in connection with the voluntary disclosures, and it was

sometimes difficult for him to separate what he learned in connection with the disclosures versus what he may have known at the time.

### ***Background***

Mr. Girard began with a summary of his education and work experience. He graduated from San Diego State for his undergraduate education, and from Georgetown for his JD, which he got in 1981. He was hired straight out of law school by the City Attorney's Office ("CAO") for San Diego, into its Criminal Division. He moved on to its Civil Advisory Division, and from there to its Litigation Division. He stayed in the Litigation Division for 11 years and then once again moved back to the Civil Advisory Division. In 1996, a new City Attorney was elected, and he was promoted to Assistant City Attorney for Special Projects (replacing Curtis Fitzpatrick), working on a variety of projects including those related to the sports teams. He remained in that position throughout the remainder of Gwinn's administration, and then for about nine months into Aguirre's tenure, and then he left the CAO on 09/23/04.

### ***Wastewater Issues***

The first time Mr. Girard learned that compliance with the State Water Resources Control Board's ("SWRCB") organics requirement was a "significant issue" was in January or February 2004, at the time he learned that the State was threatening to recall the loans. The issues connected to sewer usage did not fall under his job responsibilities. Kelly Salt had sewer-related responsibilities with respect to certain bond offerings, since she was the CAO representative for a variety of offerings. The City also always hired bond and disclosure counsel as well, since it did not have the necessary expertise. Prop 218 also raised a number of issues with respect to sewer usage. He recalls that Teresa McAteer was the person within the CAO who was the first to be knowledgeable about the notice and voting requirements under Prop 218 (and the issue of whether sewage constituted a property-related fee), though he does not think she focused on the proportionality requirement of Prop 218. When McAteer left the CAO, Salt took over that role relating to notice and voting. In essence, Mr. Girard characterized Salt as the CAO representative on wastewater rate issues with respect to the notice and voting requirements of Prop 218.

Exhibit 1 (COS 024) is an email from Salt to Vattimo (cc: Kahlie, Mr. Girard) dated 1/25/99 re: "Cost of Service Study-Forwarded." The email states that the City's position is that, "while we do not concede that our service charges are subject to Prop 218, we are complying with it in order to avoid any issues with the rating agencies and any litigation." Mr. Girard does not recall this specific email but does generally recall that the applicability of Prop 218 to sewer fees was an issue that the CAO generally tracked. Mr. Schachter put into context for Mr. Girard that, shortly after the date of this email, the City issued sewer revenue bonds. Mr. Girard was then shown Exhibit 2 (COS 005874), the 1999 Sewer Revenue Bond Official Statement. Mr. Girard said that he did not have any role in preparing or reviewing any part of the document. He said he did not have any role with respect to the Prop 218 or the regulatory sections, and that he would have had no reason to review Exhibit 2. He thinks he did not review it even in September 2003, when he got involved in the voluntary disclosure issues. With respect to the language at COS 005904-05, that "the City's rate structure has been reviewed by the State Board and no grant funds or costs under grant funded programs have been disallowed based on the nature of the rate structures," Mr. Girard said that, to the best of his knowledge, he did not discuss the language of that particular sentence with anyone. When he became involved in

getting the Council to adopt a compliant rate structure in 2004, he never went back to look at the disclosure.

Exhibit 3 (no bates) is a memo from Mr. Girard to the Mayor and City Council, transmitting a Bryan Cave memo dated 11/06/01, re: "Review of Disclosure Documents as to Lease Revenue Bonds in 2001." Mr. Girard is familiar with the memo. He said that the primary project he worked on was the ballpark project. From early 1998 through 2004 there was a substantial amount of work related to it. The history behind Exhibit 3 is that the City had planned to issue bonds to fund the ballpark project, and it was discovered that one of the Councilmembers had received gifts from the Padres (the baseball team), and so that Councilmember resigned. That incident led to efforts to impress upon the City Council to beware of conflicts of interest. In a November 2001 closed session, Mr. Girard brought in Webber, Anhut and Boltz to do a presentation with respect to Councilmembers' duties in connection with offerings. He does not recall specifically what was discussed at the presentation. The purpose of the memo was for Boltz to walk the Councilmembers through their obligations with respect to the issuance of bonds. In Mr. Girard's mind, the goal was to avoid future conflicts and other issues. Mr. Girard thinks the presentation lasted about 10 minutes and that Council was walked through their disclosure duties and obligations. Mr. Girard does not recall whether the exact words "10(b)-5" were used, but the substance of the memo was conveyed to Council. They impressed upon Council the need to ask questions, and read Official Statements. He does not recall if, in the presentation, the distinction was made between an omission and a false disclosure, but he speculates that it would have been.

Mr. Schachter asked Mr. Girard whether he had ever seen a draft sewer cost of service study ("COSS") dated November 2001, or a final one dated January 2002. Girard said he did not see them at the time and is not sure he ever did, and he noted that they were not within his area of responsibility.

Exhibit 4 (no bates) is a memo from the City Attorney's Office, dated 12/06/01, re: "The Application of Article XIID to Sewer Fees." Mr. Girard said it was a closed session report that he thought was authored by Salt. The memo sets forth the risks associated with not complying with the noticing and vote requirements of Prop 218, and it recommends that the City be conservative and comply with it. Exhibit 5 (no bates) is a "Closed Session Report" dated 01/29/02, that has Mr. Girard's signature on it. Mr. Girard has a vague recollection of that closed session. Generally speaking, Mr. Girard described that the process for closed session is that someone writes a memo, it is then distributed in advance, a report is made on the memo, and questions may or may not be asked. Mr. Girard thinks that the December 2001 memo was discussed in late January 2002 and was written because someone had threatened a lawsuit about noncompliance with the noticing and voting provisions of Prop 218. Mr. Girard recalls that Salt gave the presentation and that no action needed to be taken because the City was already complying with the noticing provisions. Mr. Girard said that Bromfield was the one that was most knowledgeable in the CAO about sewer issues. Mr. Girard would regularly attend closed sessions and with forms such as Exhibit 5, he would check off the objective fields. His signature on the bottom confirms that his own handwritten version of the document conforms with the version that was subsequently typed. At the January 2002 closed session, he does not recall Kahlie making a presentation, but does recall questions being asked of Kahlie (with no recollection of the substance of those questions). As to the note on Exhibit 5, "note and file," Mr. Girard thinks he would have written that himself. The note, "City Attorney to analyze," in

conjunction with “note and file,” meant that no one has requested that action be taken. Girard thought those notes related to the Prop 218 issue.

Exhibits 6 (COS 4861) (email from Kahlie to Mr. Girard, dated 4/15/04, re: “1/29/02 Closed Session Matter”), and 7 (COS 4863) (email from Mr. Girard to Kahlie, dated 4/15/04, re: “1/29/02 Closed Session Matter”) were shown to Mr. Girard. The emails discuss Kahlie’s and Girard’s versions of what occurred at closed session in January 2002. Upon reviewing them, Mr. Girard continued to claim that he had no “independent recollection” of Kahlie making a presentation or in substance making the statements about the City’s contractual obligation to have compliant rate structures. Mr. Girard described that his comment in the April 2004 email about the discussions not being “well received,” was, as he understood the issue at the time of writing the email, a reference to discussions about voting requirements under Prop 218 not being well received. As he thought further about what he knew, and when he knew it, Mr. Girard corrected his understanding. He said that his understanding as of 2002 was that the City was to opine on the Prop 218 voting requirements, but as of the time he wrote the email to Kahlie in 2004, by then he had an understanding of the SWRCB requirements. He said that in 2004, Frye and others alleged that the City Council was voting to hide the COSS.

He does not recall being aware in 2002 that it was necessary to include an organics component in the rate structure, nor does he recall Kahlie describing that the recall of loans was a potential consequence of being out of compliance with the loans.

Looking back at Exhibit 4, the December 2001 memo, Mr. Schachter focused Mr. Girard on the language about the need to comply with Prop 218 in light of bond disclosures. Mr. Girard said that the only disclosure item he recalls discussing in closed session was that since the City was already complying with notice and voting requirements, there was no disclosure to be made in that regard.

Exhibit 8 (DK 05347) is an email from Kahlie to Frazier dated 11/7/02. The bottom string is an email from Salt that references her having incorporated “Les’s” changes to her memo. Exhibit 9 (no bates) is a draft memo from Vattimo and Salt to the Mayor and City Council, dated October 31, 2002, re: “Significant Exposure to Litigation: Metropolitan Wastewater Department’s Compliance With Federal and State Loan and Grant Guidelines.” Mr. Girard said that he reviewed an “awful lot” of memos for closed session, and he could not say whether or not he commented on it. Upon Mr. Girard’s reviewing Exhibit 9, he said he had a “vague” recollection of having seen it before, but he does not recall what, if any, comments he made to it.

Mr. Schachter asked Mr. Girard whether reviewing the memo refreshed his recollection of what the Council asked the CAO to look at in January 2002, and he said that it “could have been” to look at the issue analyzed in Salt’s November 2001 memo, but he thought the Council’s direction was to keep monitoring the Prop 218 issues referenced in Salt’s December 2001 memo. Mr. Girard recalls that in the course of his activity with voluntary disclosures in the Fall of 2003 and Winter of 2004, it came to his attention that people were saying that the Council would not change the rate structure. Upon looking at Exhibit 9, Mr. Girard acknowledged that he was confused about the timing of whether he knew it before the Fall of 2003 time period. Separately, as to why he would have given comments to Salt on Exhibit 9, Mr. Girard said it would have been his practice to review virtually all closed session

memos, not so much for content as for form. He estimated that he has reviewed thousands of such memos over the course of time.

Mr. Friese clarified that Mr. Girard frequently presented to the Council information in summary form of other's work product. Mr. Schachter observed that the recommendation in Exhibit 9 from the CAO, for Council to change the rate structure, was never discussed by City Council, and asked Mr. Girard how that could be. Girard had no recollection of whether the issue was discussed there or not, but described the general closed session process whereby the CAO prepares a draft agenda for closed session items. Presenting parties can ask for more time if they need it. He also hypothesized that the Mayor or the Council could ask for an item to be removed, or Council could run out of time to discuss an item in any particular session. Mr. Girard does not recall why (or even that) this particular item did not make it on.

Exhibit 10 (no bates) is an email from Kahlie to Ryan, Loveland and others, dated 11/13/02, re: "revision #2 to COS Briefing document," with a document attached, entitled "Salient Points: Sewer Cost of Service Compliance Issue, November 13, 2002." Mr. Girard has no independent recollection of seeing it at that time, or ever before.

Exhibit 11 (no bates) is a closed session agenda dated 11/14/02 that is signed, and thus apparently authored by, Devaney. Mr. Girard cannot say whether he ever saw it before. Exhibit 12 (COS 4903) is a memo from Mr. Girard to Frye, dated 11/18/02, re: "Item No. 7, Closed Session Agenda for November 19, 2002." Mr. Girard does recall this memo. The second sentence of Mr. Girard's memo (Exhibit 12) appears to be a reference to item IIA of the closed session agenda, which provided as an agenda item for a November 19, 2002 closed session, "Conference with Legal Counsel - anticipated litigation, significant exposure to litigation, pursuant to. . ." He recalls that Frye was questioning the ability to go into closed session with the issue and that he had to respond to her, but to do so, he had to reconstruct the item she was referring to. In his opinion the description of the agenda item is sufficient to satisfy the Brown Act, and at the time, he was looked to for advice as to what would satisfy Brown Act requirements, though he was not always the final word on this subject.

Having looked at Exhibits 11 and 12, he still could not recall how the compliance issue came to be removed from the closed session agenda, and did not recall the fact that it had been taken off. If the item was actually on the Agenda and not discussed, it would have "O/C" for "off calendar" noted in the minutes, and similarly, if the item were "continued," that would be noted as well. In reviewing his memo (Exhibit 12), Mr. Girard said that his understanding of the issues must have come from Salt's memo. In order to respond to Frye, he had to understand what the memo was about and the CAO's scope of advice. His justification for proceeding with the issue in closed session was that the CAO was advising on litigation risk, and Frye would not be asked to move on the rates in closed session. He does not recall who told him that the draft was still in progress, but he would have had to ask someone, perhaps Salt, Bromfield, or the City Manager's office. He also thinks he must have been told by someone else that they did not have the study in their possession. He guesses he discussed it with Salt since she authored the memo. As to whether he talked to anyone about how to respond to Frye, he guesses he may have spoken with either the City Attorney or Executive City Attorney. While he has no specific recollection of discussing the response with anyone, he thinks he must have, because he did not have the knowledge himself to put the memo together.

He does not recall having discussions about the City's non-compliance with anyone (i.e. the issues underlying Salt's 10/31 draft memo) and reiterated that that was not something he was responsible for. What he recalls knowing at that time was that there was a cooperative effort with the State to work on the City's rate structure. He did not discuss with anyone disclosure implications as a result of the City's lack of compliance, and said that that was not his job. He recalls learning from someone (perhaps Bromfield or Kahlie) at some time that there were different ways to measure proportionality.

Mr. Girard does not recall Salt ever making the statement that she thought that the City was in compliance. Exhibit 13 (MWWD-BH 840) is another version of the draft memo to the Mayor and City Council from Salt, dated October 11, 2002. This version has a portion under the "Discussion" heading that discusses the typical loan terminations in the various SRF contracts (at 0845). He does not recall deleting or directing Salt to delete that portion of the memo and said he would not have done so, as he would not have been in a position to do that.

Exhibit 14 (no bates) is a one page memo discussing the January 2002 closed session, with no date and no author. Mr. Girard thought the memo looked familiar but thought he may have seen it in connection with a 2004 closed session. He does not know who prepared it.

Exhibit 15 (COS 006959) is the draft Official Statement, dated June 10, 2003, for the 2003 sewer revenue bond offering. Mr. Girard did not review this document in the time leading up to its consideration or release in the Summer of 2003, but may have reviewed it later. He did not discuss with anyone at anytime since that document was drafted, why the non-compliance was not disclosed, or how the language got included that "no funds have been disallowed." He did not have any role in connection with the release of the document.

Mr. Girard described the history of his becoming familiar with the non-compliance issue. He thinks it may have been in late 2003 that he attended a closed session discussing problems with the pension and CAFR-related issues. After the meeting, Frye approached Mr. Girard and told him that she needed to speak with Webber about the COSS, and Mr. Girard put the two in touch and they talked on the side. Webber subsequently contacted Mr. Girard and asked Mr. Girard to put Webber in touch with those who would be most knowledgeable on the issues, and Mr. Girard thinks he referred Webber to either Salt or Bromfield. He said it was around that same time that the City got a letter from the State. Webber then worked on the Voluntary Disclosure while the City moved forward to implement a compliant rate structure. Mr. Girard made sure the rate issue got on the agenda and approved by June, 2004, as per the State's demand.

Exhibit 16 (COS 7117) is a memo from Mr. Girard to the Council dated 03/26/04, re: "Continuing Disclosure Reports for Metropolitan Wastewater Utility and Water Utility." The memo contained a description from Mr. Girard to the Council about the details surrounding the Voluntary Disclosure. Exhibit 17 (no bates) is the March 26, 2004 Voluntary Disclosure (in the wastewater annual financials). Mr. Girard said that Webber was the primary author of the disclosure and that Mr. Girard reviewed various drafts of it. He does not recall whether he made any substantive comments to it. By way of (unsolicited) explanation as to why the wastewater disclosure did not make it into the January 2004 Voluntary Disclosure, Mr. Girard explained that that disclosure was primarily related to the general fund. Since impacts relating to the special funds were slightly different, there were discussions about the proper vehicle to disclose each

issue (meaning pension, wastewater, etc.). Mr. Girard thinks that the decision was made to disclose wastewater issues in an annual report disclosure in March 2004 since the disclosure was a continuum. The only reason the wastewater disclosure was in front of him was because of his involvement in the other, pension-related issues.

Mr. Schachter asked Mr. Girard who decides what needs to be disclosed, and Mr. Girard said that is the reason they hire outside disclosure counsel. He had a variety of conversations with Webber about disclosure issues. When Webber became aware of the COSS issues, Webber felt "there was clearly a need to disclose it." There was much correspondence with Webber and Dan Deaton and the City, oftentimes sending emails to Mr. Girard for him to pass on questions to people. Mr. Girard offered that the amount of information that needed to be gathered could also explain the delay in closing from January to March. Though Webber circulated drafts of the Voluntary Disclosure, Mr. Girard said he did not, "dive into substance." Mr. Girard was asked by Webber to help get answers to questions, which he did, but he still had a lot of other responsibilities on his plate at that time, so there was a lot that Webber would copy Mr. Girard on, that Mr. Girard would not review.

Mr. Girard did not have conversations with Webber regarding whether Webber had known the City was out of compliance. However, Mr. Girard speculated that it was news to Webber when Frye brought him up to speed. He does not recall discussing with anyone that Webber knew of the issue prior to Webber's discussion with Frye. Mr. Schachter asked Mr. Girard whether he participated in the decision as to whether the City's lack of compliance needed to be disclosed, and Mr. Girard said that when he saw the November 2003 letter from the State, "the significance of disclosure" was made clear to him. Prior to that, however, he never knew it was a disclosure issue.

Exhibit 18 (no bates) is a letter from Ron Blair to Mike Uberuaga dated November 26, 2003. The difference between his understanding based on Salt's compliance memo and the letter from the State was that he understood from Salt's memo that the City was working toward compliance. However, the letter from the State signaled to him that maybe the City did not see it that way. He thinks someone showed him the letter in January, 2004. He thinks that, in 2004, he probably spoke to Webber and may have spoken to Salt about the issue being a disclosable event, but he does not recall speaking to anyone about why the lack of compliance was not previously disclosed. Mr. Girard has no recollection of Webber saying he felt betrayed by the City in connection to wastewater.

Looking back at Exhibit 6 (COS 4861), the email from Kahlie to Mr. Girard about the January 2002 closed session, there is a reference in the email to a meeting in the Mayor's office. He vaguely recalls a meeting in the Mayor's office that was about the need to comply with the new rates by June 2004, and he thinks the meeting was intended, at least in part, to ensure that it got done. He thinks something came up at the meeting about what had happened historically with the sewer user rates. He does not recall what prompted his question to Kahlie about whether Kahlie had attended the closed session. He does not recall anyone suggesting that the COSS has not been brought to Council's attention. He is not sure who else may have been at that meeting, but he speculates it would have been Vattimo, Frazier, Mendes, Loveland (if he had not yet retired), and Salt. It made sense to Mr. Girard that he would have been asking for the history of events in connection with the rate structure because it was the Mayor's way to handle meetings, to methodically review what had happened, and to address next steps.

Exhibit 19 (COS 5554, Tab 28) is a memo from Mr. Girard to Vattimo re: "Disclosure Practices," dated 05/04/04 (with a 04/09/04 "chronology of events" attached). At COS 5557, he said the handwriting was not his, and he did not recognize it. One of the notes stated, "November letter from SWRCB → not given to Paul because it was known." Mr. Girard had no knowledge who wrote that. He had a vague recollection of receiving it. He did not request it from Vattimo and had no conversation with her about it in advance of receiving it from her. He thought it was motivated by Vattimo being upset about things people were saying about her department (for example, that they were not cooperating with Webber and were hiding things from him), and this was probably her response to those accusations. He does not recall whether he talked to her about it after receiving it. He doubted he would have spent a lot of time on the document since he had a lot going on at that time.

Exhibit 20 (COS 4283), entitled "SWRCB Grant/Loan Obligation Disclosure Issue," dated 04/26/04, is a document tracing the history of whether disclosure counsel should have known of the City's non-compliance. It was transmitted with other attachments to Mr. Girard and others from Vattimo on May 18, 2004 (COS 004272). He does not recall having any conversations with Vattimo about the document. He felt like he was stuck in the middle between Webber and the City staff, and he viewed his role as making sure whatever needed to get done would get done. He saw this as Vattimo wanting to put her version of events in writing and thinks she was trying to create a record for the impending investigation of SEC and U.S. Attorney's Offices. He does not recall having discussions to verify or refute what Vattimo was saying, but he thinks he probably reviewed the document. He does not recall discussing the document with anyone, does not think he saw it as significant, and saw it as a "CYA."

Exhibit 21 (COS 004853), an email from Salt to Katz, Mr. Girard and Bromfield, dated June 2, 2004, transmitted a request to gather certain historic materials for Mr. Girard, including the Salt memo where the "Council was warned of a possible claim." Mr. Girard recalls requesting the information in connection with preparing for the closed session on adopting the new rates, and he wanted to have that information to present to the Council as background. Focusing again on Salt's memo, he said the memo did go to the Mayor and City Council. He speculated that Council may not have wanted to implement the rate change for political reasons.

Mr. Schachter turned the focus to ISP and Kelco, and Mr. Girard cautioned for purposes of full disclosure that his new firm represents ISP but that he has been sectioned off from their work. He said he has heard rumors of campaign contribution from at least Kelco to some or all of the Councilmembers, but that he has never heard about any improper contributions or any references to Kelco giving anything of value to anyone from the City Manager's office.

Exhibit 22 (CSD/MAI006318) is an email from Terri Webster to Mr. Girard and others, dated 06/26/04, re: "Retirement Payment." He does not recall the email, but in reading it, he observed that it discussed the issue of transfers from enterprise funds to general funds. He recalls an issue relating to whether the City could charge right of way fees as a percentage of revenue, and that issue was connected to the transfer of fees from one fund to another. He advised that calculating them based on percentages was not proper, and that they should be calculated based on the amount of value. His opinion was that, provided a particular approved calculation methodology was used, transfers were legal. This email seems to be unrelated to the focus of our inquiries.



Before the interview concluded, KPMG had one point for clarification. Mr. Yazdi asked about the previous statement Mr. Girard made that Council "for political reasons" may not have wanted to raise rates. Mr. Yazdi asked whether the rate change actually would have had the effect of *lowering* rates for residents, while increasing for industry. Mr. Girard agreed that that was the case, and he may have misspoken earlier by stating the opposite.

With no further questions, Mr. Fries commented that, in connection with his representation of 11 individuals from the City, his office had culled the wastewater documents, and a few things stood out. First, while one letter from the State showed a hard June 2004 deadline to implement the new rates, it appeared in another letter that the State was "backing off." Mr. Fries also said that there was a lot of correspondence from Deaton to the City requesting information. Lastly, he emphasized that the reason disclosure was made in March 2004 rather than earlier in January was that they wanted to make sure they had all facts and did not want to go to the market with something half-disclosed.

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